No. 157

In the Supreme Court of the United States

October Term, 1942

Lawrence C. Phipps, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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CITATIONS

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OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 24–49) is reported in 43 B. T. A. 1010. The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 183–194) is reported in 127 F. (2d) 214.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 23, 1942 (R. 194). The petition for writ of certiorari was filed on June 17, 1942. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the court below erred in sustaining the finding of the Board of Tax Appeals with respect to the value of certain stock on the date of its gift in 1935.

2. Whether the full gift tax exemption of \$50,000 allowed by Section 505 (a) (1) of the Revenue Act of 1932 had been exhausted by gifts made in prior years.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the Appendix, *infra,* pp. 15–17.

STATEMENT

This gift tax case involves gifts made by the taxpayer in 1935 and raises two questions: (1) whether the court below correctly refused to disturb the finding of the Board of Tax Appeals that the seven per cent cumulative preferred stock of the Nevada-California Electric Corporation had a market value of \$51 a share on the date of gift; and (2) whether the \$50,000 gift tax exemption had already been exhausted by other gifts made in earlier years.

1. *Facts with respect to valuation issue.*—The petitioner made various gifts of securities on October 15, 1935. Among those securities were 10,000 shares of seven per cent cumulative preferred stock

of the Nevada-California Electric Corporation which he divided among thirteen separate donees in varying amounts, ranging from 2,500 shares to 100 shares. Petitioner reported these gifts at $50 a share which he believed was the market price of the stock in Denver on the date closest to the date of the gifts. The Commissioner increased the value to $51 a share, the price at which such stock was sold on the New York Curb Exchange on the date of the gifts. In the Board of Tax Appeals, the petitioner sought to establish a value of $40 a share, but the Board sustained the Commissioner's determination and found that the stock had a fair market value of $51 a share (R. 27–28, 32). The facts found by the Board in support of its ultimate finding are as follows:

The Nevada-California Electric Corporation, organized as a Delaware corporation in 1914, was a holding company in 1935, owning nine subsidiary companies, which are utilities operating companies in the region of California and Nevada. Its plan of financing has been to issue its capital stock, bonds, and other securities in exchange for the stocks and bonds of underlying and associated companies, for working capital, and for other purposes. After 1935 it became an operating company. Its authorized capital stock consisted of $25,000,000 par value preferred stock and $25,000,000 par value common stock. As of December 31, 1934, the preferred stock outstanding in the

hands of the public was $10,483,300, par value $100 a share; and the outstanding common stock was $8,468,300. As of the same date the bonded indebtedness was $28,407,500, and its consolidated surplus, exclusive of reserves and exclusive of dividends of $734,789, was $2,157,553.02. As of December 31, 1933, surplus was $1,844,705.74. As of December 31, 1935, surplus was $3,092,139.27. Earned surplus for 1933 was $521,944.63; 1934, $389,229.51; 1935, $871,938.21. Earned surplus available for redemption of bonds, dividends, etc., as of August 31, 1935, was $608,207.08 (R. 28).

At the end of 1934 the financial position of the Nevada-California Electric Corporation was sound. From 1920 through 1934 the gross operating earnings of its associated companies had increased gradually from $3,074,517 to $5,209,151. The gross operating earnings of the associated companies from 1929 through 1934 were as follows: 1929, $5,674,700; 1930, $5,672,386; 1931, $5,650,825; 1932, $5,060,612; 1933, $4,782,608; 1934, $5,209,151 (R. 28).

From 1930 through 1935 the seven percent preferred stock carried a dividend rate of $7 per share, except in the year 1933, when the rate was $4 a share. Earnings per share were as follows: 1930, $7.76; 1931, $6.38; 1932, $3.56; 1933, $3; 1934, $2.34; 1935, $6.51. (R. 28–29.)

For the year 1934 the corporation declared cash dividends of seven percent on outstanding pre-

ferred stock aggregating $734,661. For the year 1935 it declared cash dividends of seven percent on outstanding preferred stock, aggregating $733,667. At the end of both years dividends in arrears on the seven percent cumulative preferred stock were three percent or $3 per share (R. 29).

As of December 31, 1934, there were 104,833 shares of the seven percent preferred stock outstanding in the hands of the public. The stock was not closely held and as of November 12, 1935, there were 1,163 individual stockholders. Only one stockholder held a block of from 10,000 to 20,000 shares and no one person held more than 20,000 shares. Only 10 stockholders held a block of from 2,000 to 10,000 shares; 10 persons held from 1,000 to 2,000 shares; 52 persons held from 200 to 1,000 shares; 72 persons held from 100 to 200 shares; and 1,018 stockholders held stock in lots of less than 100 shares (R. 29).

Ownership of the seven percent preferred stock was concentrated in California (523 stockholders) and Nevada (472 stockholders). Otherwise ownership throughout the United States was scattered thinly, there being 168 stockholders in 30 other states (R. 29).

The market for the seven percent preferred stock was concentrated in Denver where transactions took place over the counter. The stock could be listed on the New York Curb Exchange, but it was not dealt in on that exchange except infrequently.

Transactions from other cities than Denver were frequently carried out in Denver (R. 29).

Market conditions in general in 1935 showed advances in prices of securities from March to the end of the year. Market prices of stocks of utility companies advanced during 1935 and during October of 1935. Market prices of comparable seven percent preferred utility stocks advanced in October of 1935. Market prices of the Nevada-California Electric Corporation seven percent preferred stock advanced throughout 1935 and during October of 1935 (R. 29). In Denver transactions over the counter showed increases in market prices of the Nevada-California preferred stock as follows (R. 30):

	High	*Low*
January	44	37
August	50	44
October	55.50	46.25
December	70	64

On October 15, 1935, the date of the gifts, 50 shares of Nevada-California preferred were sold on the New York Curb Exchange at $51 a share (R. 30).

During 1935 trading in Denver in the Nevada-California Electric seven percent preferred stock, purchases and sales, involved at least 10,946 shares. Transactions usually were in small lots of 10, 25, 50, 100 shares, or in comparable lots. There were about 28 transactions involving the purchase or sale of the preferred stock in lots of about 100 shares. There were six transactions involving purchases or

sales in lots of from 150 to 250 shares; three transactions involving from 300 to 550 shares, one transaction involving 800 shares; and one transaction involving 1,000 shares. During 1935 the purchases or sales of the preferred stock on the New York Curb Exchange involved 275 shares (R. 30).

The sales or purchases of the preferred stock in Denver in October of 1935 were made at prices ranging from $46.25 on October 1, to $55.50 on October 29. The purchases or sales were for small lots of stock of 88 shares or less (R. 30).

The Nevada-California Electric Corporation issued monthly operating statements which showed gross operating earnings for the month, for the 12 months including the current month, and comparative gross earnings for the same month of the prior year and of the prior 12-month period. The last report issued prior to October 15, 1935, covered the month of August of 1935 and is dated September 23, 1935. The corporation issued detailed annual reports to its stockholders (R. 30–31).

The operating earnings of Nevada-California Electric Corporation from January 1 to August 31, 1935, were $533,191.55, as compared with $389,-264.18 for the same months in 1934, which represented an increase in 1935 over 1934 of about 36.97 percent. The operating earnings for June, July, and August of 1935 aggregated $374,175.85 as compared with $135,950.40 for the corresponding months in 1934. The increase of operating earn-

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ings in 1935 for these three months compared with the same months in 1934 was 275 percent (R. 31).

The surplus, before dividends, earned in each year by the corporation, exclusive of gains from the sale of certain Los Angeles property amounting to $1,150,668.62 in 1934 and $1,216,892.11 in 1935, was as follows (R. 31):

Year	Surplus earned during year	Shares of preferred stock outstanding	Per share of preferred stock
1930	$849,416.79	111,388	$7.62
1931	749,351.64	112,212	6.68
1932	602,395.33	110,820	5.44
1933	521,944.63	105,503	4.95
1934	389,229.51	104,833	3.71
Subtotal	3,112,337.90		[1] 5.71
1935	871,938.21	104,806	8.32
Total	3,984,276.11		[2] 6.13

[1] 5-year average.
[2] 6-year average.

The earnings on the preferred stock based on the selling price of $51 on October 15, 1935, were 11.19 percent for the prior five years and 12.02 percent for the six years including 1935 (R. 31).

During 1934 the corporation reduced its bonded and debenture debt in the hands of the public by $1,857,200, thereby reducing the interest charges thereon by $90,185.69. The interest for a full year on the decreased indebtedness would have amounted to $96,642. During 1935 the corporation reduced its bonded and debenture debt in the hands of the public by $1,616,800, thereby reducing interest charges on this debt by $60,920.94. The saving in

interest for a full year on this decreased indebtedness amounted to $83,928. In August of 1935 the corporation realized a profit of $146,406.90 from discounts obtained in retirement of bonds and debentures (R. 32).

The unappropriated surplus at the end of 1934 and 1935 was $2,157,553.02 and $3,092,139.29, respectively (R. 32).

The Board's finding that (R. 32) the value of each gift of shares of the seven percent cumulative preferred stock of the Nevada-California Electric Corporation on October 15, 1935, was $51 per share was affirmed by the Circuit Court of Appeals (R. 194).

2. *Facts with respect to the exemption issue.*—Under Section 505 (a) of the Revenue Act of 1932 there is a total specific exemption of $50,000 which must be diminished, however, by "the aggregate of the amounts claimed and allowed as specific exemption for preceding calendar years."

In 1932 petitioner made gifts for which he claimed and was allowed a specific exemption of $12,000, thereby leaving $38,000 available as exemption for later years (R. 25).

In 1933 petitioner made several gifts and he filed a federal gift tax return. In the return he reported gifts aggregating $76,850, exclusive of gifts of First Liberty Loan bonds, aggregating $163,583.33, stating in the return that he believed the gift of Liberty bonds was not subject to federal gift tax.

Petitioner claimed a "specific exemption" deduction of $11,850 in the return against the total gifts reported in the amount of $76,850 which, together with other allowable deductions, resulted in no tax due on the return as made (R. 22, 25–26).

Upon auditing the gift tax return for 1933, the Commissioner determined that the gifts of the Liberty bonds were taxable and he increased the aggregate of gifts to $240,433.33. At the same time, the Commissioner increased the deduction for the "specific exemption" from $11,850 to $38,000. Upon these determinations and exemptions the Commissioner determined a deficiency in gift tax of $4,108.17. The deficiency would have been greater if the deduction for the "specific exemption" had not been increased. The deficiency notice was mailed February 28, 1935. Petitioner filed a petition with the Board on March 27, 1935, contesting only the Commissioner's action in increasing the total amount of gifts made in 1933. He did not protest at that time nor allege (in the proceeding before the Board or the Circuit Court of Appeals) that the Commissioner erred in increasing the "specific exemption" to $38,000. The Board sustained the Commissioner's determination (*Phipps* v. *Commissioner,* 34 B. T. A. 641) and entered a decision on June 10, 1936, that there was a deficiency in gift tax for 1933 in the amount of $4,108.17; its decision was affirmed in *Phipps* v. *Commissioner,* 91 F. (2d) 627 (C. C. A. 10th), certiorari denied, 302 U. S. 742 (R. 26).

Petitioner filed a gift tax return for the year 1934 but made no claim for a deduction for "specific exemption."

Petitioner filed a gift tax return for the year 1935, and in that return he claimed a deduction of $26,150 for "specific exemption," that amount being the difference between $50,000 and $23,850. Petitioner computed his gift tax liability for 1935 on the basis of having claimed deductions for specific exemption in prior years in the amounts of $12,000 for 1932 and only $11,850 for 1933. The Commissioner, on July 20, 1936, advised petitioner that he proposed to determine a deficiency in gift tax for 1935 which would result in part from disallowance of petitioner's claim for deduction of $26,150 as a "specific exemption." The Commissioner gave as explanation the following: "Specific exemption of $50,000 has been allowed as follows, calendar year 1932—$12,000 and calendar year 1933—$38,000" (R. 26–27).

The Board in the instant case concluded that the petitioner received, prior to the taxable year 1935, all of the statutory allowance of $50,000 for exemptions from gift tax (R. 26), and the court below affirmed (R. 194).

ARGUMENT

1. The court below correctly refused to disturb the Board's finding that the preferred stock in question had a fair market value of $51 a share on the date of the gifts. The Board had based its finding upon all relevant factors, including not

only market quotations but also earnings, surplus, financial stability and outlook of the corporation, as well as the opinion of expert witnesses as to the effect of the so-called blockage theory upon market value (R. 41, 42, 46–47).

Petitioner's principal reason for allowance of the writ is in essence founded upon the failure of the Board to give greater weight to the blockage theory. The Board, however, did take the blockage theory into account, but merely decided that there were other factors in this case which appeared to have greater significance.

We recognize the importance of having this Court pass upon the blockage theory, and indeed we asked the Court to do so in *Helvering* v. *Maytag*, 125 F. (2d) 55 (C. C. A. 8th), but certiorari was denied, Nos. 1161–1162, 1941 Term. But even if the Court were now disposed to consider the question, the instant case is not a suitable one for that purpose. For, the Board in this case did accept evidence relating to blockage and took it into account; accordingly, even if the petitioner should prevail in his contention in this Court that the blockage theory is sound, he would not be entitled to any further relief. Certainly, no one contends that the blockage theory is conclusive, and the only question is whether it is a relevant factor. It is the Government's position that it is not a relevant factor at all. But the Board did consider it here, contrary to our general position, and the most that

petitioner can ask is that the Board be required to consider it again. We think that no useful purpose would be served by further review of this issue in this case.

2. The portion of the decision below which denied the right to any further gift tax exemption presents no basis for the issuance of the writ. The petitioner concedes (Pet. 14) that there is no conflict. In the circumstances here presented, it was reasonable for the Commissioner to assume that the taxpayer would have claimed all available exemption in 1933 if he had known that the amount of taxable gifts would be greater than returned. The fact that in filing his 1933 return he claimed all exemption necessary to eliminate the gift tax, under his own calculations, evidenced an intention on his part to claim so much of the available exemption as was necessary to avoid taxation at that time. See *Richardson* v. *Commissioner,* 126 F. (2d) 562 (C. C. A. 2d), which turned upon such an assumption. In this posture, it was reasonable for the Commissioner to assume that he was acting on behalf of the taxpayer in increasing the claimed exemption to offset the additional deficiency. The taxpayer was specifically notified of this act and continued to accept the benefits of the increased exemption. The Board and the court below properly concluded that it must be presumed that the taxpayer *ratified* the action of the Commissioner in increasing the exemption in the 1933 return and

that the exemption subsequently claimed in the 1935 return must be denied, the 1933 exemption as thus allowed having exhausted the statutory exemption.

CONCLUSION

There is no conflict. The decision below is correct. The petition should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
JOSEPH M. JONES,
Special Assistants to the Attorney General.

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